FedFin Client Report

Wednesday, February 5, 2025

Debanking Reform Advances on Bipartisan, Slow Senate Schedule

Client Report: DEBANKING

Executive Summary

Although there was a good deal of bipartisan agreement that debanking is problematic, Chair Scott (R-SC) said the panel will take a long look at how best to address it. Bipartisan agreement was strongest when it came to the regulatory pressures imposed on banks due to AML compliance, with Ranking Member Warren (D-MA) acknowledging this and Democrats generally showing that they are now open to SAR reform. Republicans focused their ire on regulators and the Biden Administration for targeting the crypto industry and conservative causes; Democrats targeted debanking aimed at individuals, especially lower-income populations that may not pose the risks banks seem to anticipate. A potentially explosive accusation came from Sen. Lummis (R-WY), who presented an excerpt from an internal Fed memo said to instruct staff to consider whether the "controversial commentary or activities" of an institution or its leadership poses reputational risk. Sen. Lummis argued that this policy could be used by the Fed to deny payment-system access. Chair Scott also praised the FDIC's decision today to release documents related to the supervision of crypto activities in which the agency directly asked banks to pause or suspend all crypto-related activity.

Analysis

Opening Statements

Chair Scott accused regulators of exploiting their power under the previous administration to pressure banks to cut off the crypto industry and conservative-aligned businesses and individuals, likening it to racial discrimination by banks during Jim Crow. Ranking Member Warren expressed her desire to work with Republicans to address debanking and criticized the largest banks' reliance on "do not bank" lists that blacklist consumers from the banking industry. She also described various reasons customers have been debanked according to the CFPB complaint database, argued that the CFPB is the only government agency actively working to stop debanking, and stated that regulators should issue clear AML rules to reduce incentives to use debanking as a risk management tool.

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Testimony

Nathan McCauley of Anchorage Digital described the experience of being debanked, accusing regulators of pressuring banks to shut the crypto industry out of the banking system. Stephen Gannon of Davis Wright Tremaine LLP argued that regulators intentionally use broad and vague terms subject to supervisory interpretation, enabling the supervisor to operate at their own discretion without being subject to meaningful challenge. Mike Ring of Old Glory Bank noted the significant decrease in de novo bank formations and argued that regulators coordinated to keep crypto outside of the banking industry. Aaron Klein of the Brookings Institution described various reasons that customers are debanked and provided a series of solutions, including a requirement for banks to offer BankOn accounts, reduction of surprise fees such as overdraft fees that result in debanking of the financially vulnerable, reform of "do not bank" list systems, and reform of AML and bank "overreliance" on SARs.

Q&A

- **Feedback on SARs**: Sen. Kim (D-NJ) noted that the number of SARs filed each year has grown rapidly, stating that banks do not receive feedback as to how useful these reports are; Mr. Klein agreed, arguing that banks are judged on SAR quantity rather than quality.

- **Examiner Understaffing**: Sen. Warnock (D-GA) criticized the Trump administration's federal employee buyout offers and hiring freeze for rescinding job offers to more than two-hundred new FDIC examiners, noting that the FDIC's review of SVB's failure (see *Client Report* **REFORM221**) found that the agency's team dedicated to the bank was not properly staffed; Mr. Klein agreed, criticizing the Administration's approach and emphasizing the importance of sufficient staffing for proper supervision.

- **Reputational Risk**: Sens. Tillis (R-NC) and Lummis (R-WY) stated that the term "reputational risk" is overly broad and subjective; Mr. Gannon agreed. Sen. Reed (D-RI) asked about the importance of reputational risk as a factor in bank evaluation; Mr. Klein called it a cornerstone and stated that banking is a reputation-based business. Sen. Warner (D-VA) said that reputational risk is "overused," connecting it to banks' hesitance to use the discount window, but agreed with Mr. Klein that banking is reputation-based.

- **AML**: Noting that cryptocurrency is often used as a vehicle to finance illicit activities, Sen. Reed asked if that puts additional pressure on crypto companies and regulators to monitor for illicit activity; Mr. Ring argued that banks should not be responsible for combatting violations. Mr. Klein stated that the current economics of the AML system are not aligned with its objectives, arguing that banks choose to debank low-income customers because AML compliance costs are too high and arguing that regulators too often let banks off the hook for enabling criminal activity simply by paying a fine.